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SUBJECT: FRANCH BANKERS' PITTSBURGH NIGHTMARE

¶1. (SBU) Meeting on the anniversary of the Lehman failure, leading French financiers told Ambassador Rivkin that capital requirements and accounting rules, rather than compensation, are the critical issues at the G20 Summit in Pittsburgh. They are fearful that the G20 will stiffen both capital requirements and "mark-to-market" accounting rules as the solution to the financial crisis. BNP-Paribas CEO Baudouin Prot asserted that this combination would slow world economic growth for years and could stop the current recovery. AXA CEO Henri de Castries stressed that banks could not increase capital and boost lending at the same time. He pointed out that neither raising capital requirements nor applying mark-to-market addressed the failure of regulators "to do their jobs properly." While they allowed that higher capital requirements are probably necessary, they insisted that even a phased approach would immediately be reflected in bank stock prices, making raising capital more difficult. Prot said that European bankers supported a recent letter from the American Bankers Association to Secretary Geithner urging greater flexibility in mark-to-market rules. He claimed that the only player opposed to modulating mark-to-market rules is Goldman Sachs, "and they don't hold any loans." The CEOs agreed that mark to market requirements were both procylical and increased volatility while inhibiting anything but short-term and very high quality instruments. The bankers were also concerned about moves to focus regulation primarily on leverage ratios. Credit Agricole CEO Georges Pauget warned about the difficulty of comparing leverage ratios calculated under different accounting and market standards. He said the treatment of derivatives in the U.S. for example, effectively doubled U.S. banks leverage ratios when cast according to EU standards.

¶2. (SBU) On financial sector bonuses, the bankers stated that the essence of the Sarkozy proposals (basing bonuses on bank profit, not revenue; deferral of half of bonuses to later years, with "claw-back" provisions if profits prove ephemeral; and payment of large parts of the deferred payment in stock) stemmed from the French Banking Federation work on best practices. De Castries said he the bonus standards were insufficient (and perhaps naove) and needed to be reinforced by the market. Only if clients insist on behavioral change will it actually happen - and he said the insurance and finance conglomerate he leads is now refusing to do business with financial institutions whose compensation practices "go against long-term societal interests."

¶3. (SBU) On the economy, they described the early signs of recovery around the world as "mechanical," driven by government stimulus rather than the health of the economy itself. "American consumers are still not saving enough and Chinese savers are still not consuming enough," one observed. The French economy has not been as badly hit thanks to a high consumer savings rate, low household debt and relatively less real estate market movement in recent years. Rothschild banker Gerard Worms stressed, however, that the French government deficit has jumped very sharply and will likely stay high "for years" and a number of basic economic reforms, including of labor markets, need to be carried further.

¶4. (SBU) Comment: French financiers feel vindicated by their comparatively strong performance over the last year in the face of global turmoil. The group meeting the Ambassador (which also included JPMorgan and the Caisse des Depots) were genuinely concerned about a G20 outcome that cut the financing available for growth while increasing market volatility. Their concerns seem in line with US views going into the London G20 Summit on the priority to recovery and growth rather than the EU focus on regulation.

RIVKIN